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No. 00-432

IN THE

Supreme Court of the United States

SALLY FRAME KASAKS, PAUL E. FRANCIS, JOSEPH R. GROMEK, ANNTAYLOR STORES CORPORATION and ANNTAYLOR, INC.,

Petitioners,

v.

CAROL NOVAK, ROBERT NEIMAN and JOSEPH DESENA, on behalf of themselves and all others similarly situated,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioners refer the Court to page iii of the Petition.

TABLE OF CONTENTS

	Page
Statement Pursuant to Rule 29.6	i
Table of Contents	ii
Table of Cited Authorities	iii
Introduction	1
Argument	3
I. The Circuit Split Regarding The PSLRA's Requirements For Pleading Scienter Is Not Limited To The Continued Viability Of "Motive And Opportunity"	3
II. The Second Circuit Remanded This Case To The District Court For Application Of An Interpretation Of 15 U.S.C. § 78u-4(b)(1) That Conflicts With The Plain Language Of The PSLRA And A Decision Of The Ninth Circuit	6
III. The Passage Of Time Is Unlikely To Resolve The Conflicts Among The Courts Of Appeals	8
Conclusion	10

TABLE OF CITED AUTHORTIES

Page

Cases:

Bryant v. Avado Brands, Inc., 187 F.3d 1271 (11th Cir. 1999) 5

Greebel v. FTP Software, Inc., 194 F.3d 185 (1st Cir. 1999) 5

In re Comshare, Inc. Sec. Litig., 183 F.2d 542 (6th Cir. 1999) 5

In re Silicon Graphics Inc. Sec. Litig., 183 F.3d 970 (9th Cir. 1999) 4, 5, 7, 9

Sundstrand Corp. v. Sun Chemical, 553 F.2d 1033 (7th Cir. 1977) 8

Statutes:

15 U.S.C. § 78u-4(b)(1) 1, 2, 4, 5, 6, 7

15 U.S.C. § 78u-4(b)(2) 1, 3, 4, 5

Rule:

Fed. R. Civ. P. 9(b) 6, 9

Cited Authorities

Page

Other Authorities:

H.R. Conf. Rep. No. 104-369 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730 9

Leonodis Ralph Mecham, *Judicial Business of the United States Courts: 1999 Annual Report of the Director* 389 (1999) (Table X-4) 8

INTRODUCTION

Petitioners submit this reply brief to address three new issues raised in respondents' Brief in Opposition.

First, respondents contend that the conflict among the circuits in interpreting the pleading standard for scienter in the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), 15 U.S.C. § 78u-4(b)(2), is limited to whether mere allegations of "motive and opportunity" suffice to plead intent, and that this dispute has no relevance here. The actual conflict among the courts of appeals is far broader, and reaches the more fundamental issue of whether the PSLRA merely codifies the Second Circuit's pre-existing standard for pleading intent or imposes a more rigorous standard. The Second Circuit held the former, and applied this more lenient standard to the amended complaint in this case. Four other circuit courts (including the Ninth Circuit) have held the latter. Had the more stringent standard adopted by these courts been applied below, the dismissal of the amended complaint would likely have been affirmed.

Second, respondents contend that certiorari review of the Second Circuit's interpretation of 15 U.S.C. § 78u-4(b)(1) is premature, purportedly because the appeals court remanded the case to the District Court. This contention misses the point. Section 78u-4(b)(1) requires a plaintiff to plead with particularity "all facts" supporting her belief that a fraud was committed. The Second Circuit wrote this requirement out of the PSLRA by holding that "notwithstanding the use of the word 'all,' " the statute does not require a plaintiff to plead all facts on which her belief is based. Applying its interpretation of the statute, the Second Circuit vacated the dismissal of the amended complaint, which was based on respondents' failure to identify the purported sources of their allegations. (Pet. App. at 26a-29a).

Petitioners submit that the Second Circuit's reading of § 78u-4(b)(1) is incorrect and in conflict with the statute's plain language and a decision of the Ninth Circuit that requires plaintiffs to identify the sources of their allegations. Application of this erroneous standard by the District Court on remand cannot alter the Second Circuit's interpretation or remedy these conflicts, whereas review of the Second Circuit's decision by this Court can. There is no reason for this review to be delayed.

Third, respondents suggest that consideration of the PSLRA by those courts of appeals yet to address the statute, combined with the passage of time, may lead the circuits to harmonize their divergent views. This suggestion ignores the fact that the circuits in which the overwhelming majority of securities class actions is litigated have already spoken on the issues presented in the Petition, and have reached conflicting results. It also ignores the fact that the circuit courts were unable to develop any consistent pleading requirements for securities fraud actions in the decades prior to enactment of the PSLRA. Under these circumstances, there is no reason to postpone consideration of the issues raised in the Petition.

ARGUMENT

I.

THE CIRCUIT SPLIT REGARDING THE PSLRA'S REQUIREMENTS FOR PLEADING SCIENTER IS NOT LIMITED TO THE CONTINUED VIABILITY OF "MOTIVE AND OPPORTUNITY"

Respondents concede, as they must, that the circuit courts are in conflict over whether the requirements for pleading scienter in the PSLRA, 15 U.S.C. § 78u-4(b)(2), merely codify the pre-existing standard of the Second Circuit or mandate application of a more stringent standard. (Opp. Br. at 9). Seeking to discount the significance of the split to this case, however, they inaccurately characterize its nature.

To be sure, four of the circuit courts to consider the requirements of the PSLRA held that mere allegations of motive and opportunity to commit fraud are insufficient to plead scienter, whereas two others, including the Second Circuit below, reached the opposite conclusion. (*See* Petition at 9-10). The conflict among the courts of appeals, however, is not limited to this narrow issue, but rather reaches the broader and more fundamental question of whether the PSLRA imposes a standard more stringent than that previously applied by the Second Circuit.

The Second Circuit held below that the PSLRA codifies the Second Circuit's pre-existing jurisprudence under which a plaintiff could adequately plead fraudulent intent through allegations of recklessness akin to negligence. (Pet. App. at 15a, 22a (holding that a plaintiff need only allege that

"defendants knew, or *more importantly, should have known*, that they were misrepresenting material facts related to the corporation," and that a complaint can stand if it alleges no more than that defendants "had access to information suggesting that their public statements were not accurate" or "failed to check information they had a duty to monitor") (emphasis added)). It also noted that the PSLRA requires allegations of scienter to be plead with particularity. (Pet. App. at 22a). Applying this standard, the court held that respondents' amended complaint "satisfies the standard for scienter . . . and the requirement of the PSLRA [15 U.S.C. § 78u-4(b)(2)] that plaintiffs state facts with particularity that give rise to a strong inference of the required state of mind," although it also "express[ed] no view as to whether the plaintiffs' allegations in this case were sufficiently particularized [under 15 U.S.C. § 78u-4(b)(1)]." (Pet App. at 23a-24a, 29a).

In stark contrast, the Ninth Circuit held unambiguously that "the PSLRA pleading standard is higher than the standard of the Second Circuit." *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 979 (9th Cir. 1999). The court determined that "particular facts giving rise to a strong inference of *deliberate recklessness*, at a minimum, is required to satisfy the heightened pleading standard under the PSLRA." *Id.* at 974 (emphasis added); *see also id.* at 979 ("plaintiffs proceeding under the PSLRA can no longer aver intent in general terms of mere 'motive and opportunity' or 'recklessness,' but rather, must state *specific facts* indicating no less than a degree of recklessness that *strongly suggests actual intent*") (emphasis added). It explicitly rejected the Second Circuit's pre-PSLRA requirement that plaintiffs must plead only "facts showing simple

recklessness" akin to negligence.[1] *Id.* at 974. The Ninth Circuit further held that because the plaintiff in *Silicon Graphics* had failed to plead her allegations with the particularity required by 15 U.S.C. § 78u-4(b)(1), she had failed adequately to allege scienter. *Id.* at 985.

Accordingly, it is apparent that the standard the Second Circuit applied under 15 U.S.C. § 78u-4(b)(2) below is far more lenient than the standard adopted by the Ninth Circuit, both in terms of the strength of allegations necessary to plead recklessness and the particularity with which these allegations must be stated. Respondents' assertion that review of the Second Circuit's decision by this Court would be a review of "an abstract discussion with no relevance to the facts presented" (Opp. Br. at 10) is thus demonstrably incorrect. In truth, certiorari review by this Court may well be outcome determinative in this case, as well as in the many future cases in which the courts will be called upon to apply the PSLRA.

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1. The First, Sixth and Eleventh Circuits have interpreted 15 U.S.C. § 78u-4(b)(2)'s requirements in a manner similar to the Ninth Circuit. *See In re Comshare, Inc. Sec. Litig.*, 183 F.2d 542, 550 (6th Cir. 1999) (plaintiffs must plead with particularity facts giving rise to a strong inference of recklessness "akin to conscious disregard"); *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1283 (11th Cir. 1999) (plaintiffs must allege "with particularity that a defendant acted with a severely reckless state of mind"); *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 197 (1st Cir. 1999) (endorsing Sixth Circuit's interpretation of § 78u-4(b)(2)).

II.

THE SECOND CIRCUIT REMANDED THIS CASE TO THE DISTRICT COURT FOR APPLICATION OF AN INTERPRETATION OF 15 U.S.C. § 78u-4(b)(1) THAT CONFLICTS WITH THE PLAIN LANGUAGE OF THE PSLRA AND A DECISION OF THE NINTH CIRCUIT

The Second Circuit expressed no view as to whether the amended complaint complies with the requirements of 15 U.S.C. § 78u-4(b)(1) as it interpreted the statute. Petitioner's argument that this Court should await application of the Second Circuit's interpretation of § 78u-4(b)(1) to the amended complaint before granting certiorari review begs the question actually presented by petitioners here, *i.e.*, whether the Second Circuit properly interpreted the PSLRA.

Section 78u-4(b)(1) requires a plaintiff to state "with particularity *all facts*" on which her belief that a fraud has been committed is based. 15 U.S.C. § 78u-4(b)(1) (emphasis added). The District Court adhered to this plain language by holding that respondents were required to identify the purported sources of their allegations, and that their failure to so do mandated dismissal of their original and amended complaints. (Pet. App. at 35a, 37a, 60a).

The Second Circuit rejected the District Court's interpretation of § 78u-4(b)(1), and held the requirement that a plaintiff plead "all facts" on which her belief that a fraud has been committed to mean only that a plaintiff must plead facts adequate to satisfy Rule 9(b) of the Federal Rules of Civil Procedure. (Pet. App. at 28a). Applying this interpretation of § 78u-4(b)(1), the Second Circuit held that

the District Court improperly dismissed the amended complaint for its failure to identify the purported "confidential" sources of respondents' allegations. (Pet. App. at 26a-29a).

For the reasons stated in the Petition, petitioners submit that the Second Circuit's interpretation of § 78u-4(b)(1) is manifestly incorrect, and conflicts with the plain language of the PSLRA and with the decision of the Ninth Circuit in *Silicon Graphics*. (Petition at 15-18). In contrast to the Second Circuit's interpretation, the Ninth Circuit held that § 78u-4(b)(1)'s "all facts" language

> means that a plaintiff must provide, in great detail, all the relevant facts forming the basis of her belief. It is not sufficient for a plaintiff's pleadings to set forth a belief that certain *unspecified sources* will reveal, after appropriate discovery, facts that will validate her claim.

Silicon Graphics, 183 F.3d at 985 (emphasis added). It concluded that the plaintiff's complaint fell short of this requirement, in part because it did not identify the sources of the information pled. *Id.*

Resolution of these conflicts by this Court is in no way dependent on further proceedings in the District Court, which has been charged by the Second Circuit only with the task of applying the appeals court's interpretation of § 78u-4(b)(1), and not with refining that interpretation or harmonizing it with the language of the PSLRA or the decision of the Ninth Circuit in *Silicon Graphics*. (Pet. App. at 29a-30a). Accordingly, the question of the proper interpretation of § 78u-4(b)(1) is ripe for certiorari review.

III.

THE PASSAGE OF TIME IS UNLIKELY TO RESOLVE THE CONFLICTS AMONG THE COURTS OF APPEALS

Respondents argue that consideration of the issues raised by the Petition is premature because fewer than all of the courts of appeals have interpreted the pleading requirements of the PSLRA, and the circuit courts may harmonize their views with the passage of time. (Opp. Br. at 16-19). Neither of these arguments is sufficient to warrant denial of the petition.

The six courts of appeals that have considered the PSLRA to date were host to over 74 percent of all securities class actions pending before the federal courts in 1999. *See* Leonodis Ralph Mecham, *Judicial Business of the United States Courts: 1999 Annual Report of the Director* 389-96 (1999) (Table X-4). Further, over half of all pending securities class actions in 1999 were litigated in the Second and Ninth Circuits, which — as discussed above and in the Petition — are the two circuits applying the most dramatically conflicting interpretations of the PSLRA's pleading standards.[2] *Id.* Accordingly, the courts of those circuits in which the pleading requirements of the PSLRA will be applied most frequently have already spoken.

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2. Respondents seek to minimize the conflicts among the circuits by arguing that each of the courts of appeals to interpret the PSLRA applied the definition of recklessness in *Sundstrand Corp. v. Sun Chemical*, 553 F.2d 1033, 1044-45 (7th Cir. 1977). (Opp. Br. at 17 n.12.). Respondents fail to mention, however, that the courts are in sharp disagreement over exactly what the *Sundstrand* definition means. For example, the Second Circuit views

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Moreover, respondents' assertion that the courts of appeals may over time harmonize their interpretations of the PSLRA is no more than speculation, and is contradicted by actual experience. The circuit courts applied the pleading requirements of Rule 9(b) to securities fraud actions for decades prior to passage of the PSLRA without ever settling on a consistent standard. Their failure to so do was a primary motivation for Congress in enacting the PSLRA, which was intended to create a uniform nationwide pleading standard. H.R. Conf. Rep. No. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740. The current conflict among the courts of appeals is frustrating this Congressional purpose, and is unlikely to be resolved without the intervention of this Court.

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recklessness as close to negligence. (*See* Pet. App. at 15a-16a (recklessness found where "defendants knew, or more importantly, *should have known* that they were misrepresenting material facts related to the corporation" and where "plaintiffs alleged facts demonstrating that defendants *failed to review or check* information that they had a *duty to monitor*") (emphasis added)). In contrast, the Ninth Circuit defines recklessness as nearer to intentional conduct. *See Silicon Graphics*, 183 F.3d at 977 (allegations of recklessness require "some degree of *intentional or conscious conduct*") (emphasis added).

CONCLUSION

For the foregoing reasons, and those set forth in the Petition for Writ of Certiorari, the Petition should be granted.

Respectfully submitted,

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